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Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20054

In the Matter of	)	
	)	
Telephone Number Portability	)	CC Docket No. 95-116

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COMMENTS OF U S WEST, INC.

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August 16, 1996

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SUMMARY

U S WEST, Inc., limits these comments to the subject of how carriers should be allowed to recover the massive costs of implementing the federal number portability mandate. U S WEST believes that specific Commission action is needed to enable incumbent LECs to recover these costs, while most new entrants already possess enough flexibility to make Commission action on their behalf unnecessary. The comments make three main points:

1. **Federal mandates require federal cost recovery.** Because federal law imposes the obligation to provide number portability, the Commission itself must ensure that each incumbent LEC has the opportunity to recover all of its costs that are directly related to implementing the federal mandate. The Commission may not (and should not) rely on the states to provide a sufficient recovery. The Commission should meet its obligation by authorizing incumbent LECs to recover the costs through distinct federal surcharges.

2. **The Commission must allow for recovery of <u>all</u> "directly related" costs.** While only costs that are "directly related" to implementing federally required number portability should be recovered through a federal mechanism, the Commission's definition of that category inappropriately excludes two very large areas of costs: the costs of network upgrades that incumbent LECs would not have undertaken were it not for the new federal number portability mandate, and the costs of accelerating the implementation of otherwise-planned network upgrades solely to meet the Commission's prescribed timetable. As a matter of law, sound policy, and economics, both of these costs should be recovered through the federal surcharge. The amount included should be reduced by the present value of any new revenue

streams, net of related expenses, that these upgrades actually produce for services other than local number portability, although U S WEST does not expect the net present value of such revenues to be substantial.

3. LECs must be allowed to recover costs from all end users as promptly as possible. "Competitive neutrality" requires that incumbent LECs be able to recover the costs of deploying number portability from all customers who rely on them to provide portability; this includes resellers and other end users, as well as carriers purchasing unbundled network elements if element prices do not include a share of number portability costs. In addition, incumbent LECs will spend billions of dollars under the number portability mandate to create the very competitive regime that makes long-term recovery of these costs uncertain; they should be allowed to recover these costs promptly to ensure that recovery takes place. Allowing incumbents to recover a substantial portion of these costs will quickly put incumbents and new entrants on an equal competitive footing when full competition eventually arrives. Finally, LECs should be allowed to average number portability costs across their service regions and collect the surcharge from all their customers.

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U S WEST, Inc. submits these comments in response to the Further Notice of Proposed Rulemaking, FCC 96-286 (released July 2, 1996) ("Further NPRM"). As the Commission is aware, U S WEST owns an incumbent local exchange carrier (U S WEST Communications), a cellular carrier (U S WEST NewVector),[1] and a cable TV company (MediaOne) that is upgrading its network so it can soon begin providing telecommunications services in competition with another incumbent LEC.[2] The Commission's rules require each of these firms to support number portability — a goal that U S WEST fully supports — and each will face different challenges, burdens, and opportunities in deploying this new capability. With

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1/ As the Commission also knows, U S WEST is in the process of merging its cellular subsidiary with the domestic cellular properties owned by AirTouch Communications; after the merger, U S WEST will have a minority interest in the merged company. U S WEST also has a minority interest in PCS PrimeCo, which acquired certain A and B block PCS licenses, and its incumbent LEC has submitted applications to participate in the upcoming D and E block PCS auction.

2/ MediaOne provides cable TV services in the Atlanta metropolitan area. U S WEST Media Group is investing $250 million to upgrade the MediaOne cable system to provide competitive telephone services over the system by the year's end. U S WEST also has a significant (but minority) interest in Time Warner Entertainment ("TWE"), including its cable TV properties. In addition, U S WEST has agreed to a merger with Continental Cablevision, subject to regulatory approval. Both TWE and Continental have plans to provide telecommunications services over their cable networks.

these diverse interests, U S WEST sees the subject of local number portability from a uniquely broad perspective.

Although the bulk of the Further NPRM addresses the subject of cost allocation, an equally important issue is the subject of cost recovery: How should carriers that incur costs in implementing number portability be able to recover those costs? Given how large those costs are for incumbent LECs, and given their likely difficulties in recovering those costs, U S WEST believes that this issue deserves special attention and accordingly limits its comments to this subject. Carriers cannot expect to remain in business unless they are afforded the opportunity to recover all of their costs of operation. Here, new entrants and incumbents have different regulatory needs. Most new entrants — all CMRS providers and many new competitive LECs — currently are not subject to rate regulation and, as a result, have greater flexibility in recovering their number portability costs. To the extent that the competitive marketplace permits, they can recover their implementation costs by increasing their prices for basic service or by imposing a new surcharge. These entrants do not need any affirmative action by the Commission to enable them to recover their costs, and, indeed, any Commission effort to regulate their cost recovery would decrease their flexibility.

Incumbent LECs do not have this same pricing flexibility. These carriers generally have been subject to substantial state and federal regulation concerning the costs they may recover and the methods they may use to recover these costs. Incumbent LECs often have been concerned that regulatory commissions will not allow them to recover all their implementation and operational costs with respect to a particular service, or will impose a cost recovery mechanism that is inconsistent with market realities. These carriers need the Commission to take specific action to afford them the opportunity they need to recover their number portability costs; otherwise, the successful and timely implementation of local number portability will be threatened.

BACKGROUND

The Commission's Order requires all LECs to implement long-term number portability in the 100 largest Metropolitan Statistical Areas ("MSAs") by December 31, 1998. Order at B-10 to -11. By this deadline, U S WEST's incumbent LEC will have to implement number portability in its 10 largest MSAs, encompassing roughly half of its access lines. U S WEST's incumbent LEC estimates that it will have to spend more than $400 million to comply with this mandate in its 10 largest MSAs, with substantial additional expenditures to implement number portability outside these MSAs after 1998.

The Commission has suggested that the costs of implementing number portability fall into three general categories: "costs incurred by the industry as a whole," "carrier-specific costs directly related to providing number portability," and "carrier-specific costs not directly related to number portability." Further NPRM ¶ 208. U S WEST substantially agrees with the Commission's assignment of particular costs to these three categories, with two important exceptions involving network upgrades, described below.

The "costs incurred by the industry as a whole" ("shared costs") of providing number portability in the first wave of MSAs consist of expenditures to build the service management system (the regional databases) and administration costs. Once a carrier's share of the industry-wide costs has been determined, that allocation becomes "carrier-specific" and is practically identical to the category described in the next paragraph.

The second cost category consists of the expenditures individual carriers must make that are "directly related to providing number portability." Further NPRM ¶ 208. As an example of this category, the Commission points to "the costs of purchasing the switch software necessary to implement a long-term number portability solution." Id. at ¶ 221. Other costs in this category include service control point costs, link costs, signal transfer point costs, software installation, additional switch memory and processing capability to run this software, and billing and service system modifications. In addition, as discussed in greater detail in Part II, infra, U S WEST believes that two types of costs associated with upgrading its network (to add Advanced Intelligent Network capability, for example) are properly characterized as "carrier-specific costs directly related to providing number portability": the costs of network upgrades that U S WEST would not have undertaken in the absence of the federal number portability mandate, and the costs of accelerating otherwise-planned upgrades (primarily in switches) specifically to meet the Commission's timetable. U S WEST recognizes that these last two costs may be partially offset if it in fact earns new revenues solely as a result of having sophisticated switching capacity deployed in locations where it would otherwise not have been and from having this equipment deployed earlier than expected. However, it does not believe these new revenues would be substantial; otherwise it would already have undertaken these upgrades without the number portability mandate.

The Commission's final broad cost category is for "carrier-specific costs not directly related to number portability." Further NPRM ¶ 208. This category would include the remainder of network upgrade expenditures: the non-accelerated costs of upgrades that would have been implemented even in the absence of the Commission's order.

DISCUSSION

The Commission tentatively concludes that it should prescribe a specific cost recovery mechanism for shared costs and other costs that are directly related to the federal number portability mandate, and that no such mechanism is needed for costs not directly related to that mandate. Further NPRM ¶ 209. The Commission also asks whether LECs should recover the first two categories of costs from end users or other carriers. Id. at ¶¶ 215, 222. U S WEST addresses these issues below.

I. Because the Portability Requirement Is a Federal Mandate, the Commission Must Ensure That Carriers Have the Opportunity To Recover Their Portability Implementation Costs through a Federal Number Portability Surcharge.

The duty to provide local number portability is imposed by federal law. Section 251 of the Communications Act, added by the Telecommunications Act of 1996, orders all LECs "to provide, to the extent technically feasible, number portability in accordance with the requirements prescribed by the Commission."[3/] Congress explicitly charged the Commission with the responsibility of determining how carriers should bear the costs of complying with this

[3/] 47 U.S.C. § 251(b)(2). See also 47 U.S.C. § 251(d)(1) (ordering Commission to adopt implementing regulations).

new federal mandate.[4] The Commission's jurisdiction over the North American Numbering Plan, which is directly affected by any number portability regime, is exclusive.[5] As the Commission properly recognizes in its First Report and Order ("Order"), Congress's number portability mandate rests on overriding federal interests in ensuring network interoperability, conserving telephone numbers, and promoting competition in telephony.[6]

Because the Commission and the states have independent jurisdictions and regulate different services, it is necessary to segregate the service costs attributable to each jurisdiction and for each regulator to provide for the recovery of those costs. Just as federal regulators are forbidden from dictating procedures for recovering intrastate costs where intrastate services are separable from federally regulated services,[7] so states cannot prescribe a recovery of interstate costs in place of the Commission.[8] Each regulator must take responsibility for providing recovery of the costs of services provided under its jurisdiction, and neither may depend on the other to make up any shortfall in its own cost recovery mechanism.[9] The

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4/ 47 U.S.C. § 251(e)(2).

5/ 47 U.S.C. § 252(e)(1).

6/ Order ¶¶ 2, 36-37.

7/ See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355 (1986) (forbidding Commission from setting state depreciation rates).

8/ See Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 148-49 (1930) (forbidding state from setting local pay phone rates based on costs of and revenues from providing interstate service).

9/ See Smith, 282 U.S. at 148-49 (state regulators have "no authority to impose intrastate rates, if as such they would be confiscatory, on the theory that the interstate revenue of the company was too small and could be increased to make good the loss"); Hawaiian Tel. Co. v. Public Util. Comm'n of Hawaii, 827 F.2d 1264, 1275 (9th Cir. 1987) (invalidating state separations formula that failed to provide for recovery of all costs assigned to the state's jurisdiction); National Ass'n of Regulatory Util. Comm'rs v. FCC, 737 F.2d 1095, 1113-14 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985) ("Under Smith, a portion of the costs of [the local telephone plant] are assigned to the interstate jurisdiction, for recovery under the regulatory authority of the FCC .... Local telephone plant costs are real ... and they must be recovered regardless of how many or how few interstate calls ... a subscriber makes."); cf. Public Svc. Comm'n of

Commission has just reaffirmed this principle in its recent Interconnection Order, stating that, in determining whether LECs' overall rates of return are constitutionally adequate, "we may not consider incumbent LECs' revenue derived from services not under our jurisdiction."[10/]

In this proceeding, therefore, the Commission itself must provide some mechanism by which LECs may recover all of their shared and individual costs directly attributable to compliance with the federal mandate to provide number portability. For reasons discussed in Part II, this recovery should take the form of a distinct, flat federal surcharge.[11/] Establishing an explicit federal cost recovery mechanism is the surest way for the Commission to guarantee that the federal policies underlying Congress's mandate — network interoperability, coordinated allocation of numbers, and promotion of competition — are adequately supported.

Moreover, specifying a method of recovery of new federal costs in the same order that imposes those costs would be consistent with usual Commission practice. For example, when the Commission substituted federal price caps for cost-plus calculations of interstate access charges, it explicitly noted that the new regime still must allow carriers to cover their federally attributable costs;[12/] hence, the Commission provided that the caps would be automatically

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Maryland v. FCC, 909 F.2d 1510, 1516 (D.C. Cir. 1990) (Commission may preempt state's unilateral attempt to shift intrastate costs to federal jurisdiction).

10/ Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325 ¶ 737 n. 1756 (released Aug. 8, 1996) ("Interconnection Order") (citing Smith v. Illinois Bell Tel. Co., 282 U.S. 133 (1930)).

11/ This federal number portability surcharge would fall outside the separations process, just as other new interconnection requirements will be excluded from separations and treated within "a new jurisdictional regime." Interconnection Order ¶ 364.

12/ See Policy and Rules Concerning Rates of Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6791 (1990).

adjusted upward if they failed to allow for cost recovery and specifically provided for the recovery of "exogenous costs" beyond carriers' control.[13/] Likewise, when new federal mandates have been added, such as the obligation to implement databases for 800-number portability or to deploy enhanced-911 wireless services with automatic location identification, the Commission has made sure either to specify where in an existing recovery scheme carriers may recover each new cost,[14/] or to make implementation of the mandate contingent upon providers and regulatory authorities agreeing on a new cost recovery mechanism and putting it in place.[15/]

Finally, specifying that carriers may recover the costs of implementing the new federal mandate through a distinct surcharge will ensure that the order is consistent with the carriers' constitutional entitlement under the Takings Clause of the Fifth Amendment to an opportunity to recover their reasonable expenses and to realize a fair return on their capital dedicated to public service.[16/] FPC v. Hope Natural Gas establishes that the best assurance that regulated rates will not, in their "total effect," be confiscatory is to make sure that each and every order setting rates is balanced at the bottom line and within its four corners.[17/] This obligation to

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13/ Id. at 6802, 6807.

14/ See, e.g., Provision of Access for 800 Service, Second Report and Order, 8 FCC Rcd 907, 911 (1993).

15/ See, e.g., Revision of the Commission's Rules to Ensure Compatibility with Enhanced 911 Emergency Calling Systems, CC Docket No. 94-102, Report and Order and Further Notice of Proposed Rulemaking, FCC 96-264 ¶¶ 63, 89 (released July 12, 1996); 47 C.F.R. 20.18(f).

16/ See, e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299, 307-08 (1989); Louisiana PSC, 476 U.S. at 364; FPC v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944).

17/ See Hope Natural Gas, 320 U.S. at 602 (finding no need to examine the methodology of a particular rate order when its "total effect" provides a constitutionally sufficient rate of return); see also AT&T v. FCC, 836 F.2d 1386, 1390-91 (D.C. Cir. 1988) (invalidating Commission rule requiring refunds of earnings over prescribed rate of return but not allowing recoupment of shortfalls; on its face, rule demonstrated a "systematic bias" that guaranteed carriers economic losses).

ensure that each mandate to carriers is balanced within its four corners assumes a greater importance now that telephony is shifting away from holistic rate-of-return regulation. As comprehensive, global rate orders are replaced or supplemented by discrete orders imposing various governmental mandates, there is a real risk that the many small orders will require LECs to provide a series of services at rates that are confiscatory in the aggregate. That risk is heightened where federal and state regulators impose different obligations and may be tempted to rely on each other to assure that the LEC will be able to recover its costs.[18] To avoid confiscation, therefore, each order of the Commission must, within its own four corners, allow sufficient rates to cover the costs of the obligations it imposes. In its final order, the Commission should establish a federal number portability surcharge that enables carriers to recover the costs of complying with its mandate.

II. Directly Related Implementation Costs Include the Costs of Network Upgrades That LECs Must Perform, or Must Perform Sooner Than Planned, as a Result of the Federal Number Portability Mandate.

As noted above, the Commission has tentatively divided the costs of implementing number portability into three categories — shared implementation costs, "carrier-specific costs directly related to providing number portability," and "carrier specific costs not directly related to number portability." Further NPRM ¶ 208. The Commission recognizes that some specific federal mechanism for recovery of the first two categories of costs may be needed,

[18] See Hawaiian Tel. Co., 827 F.2d at 1275 (where regulator fails to provide recovery of costs assigned to its jurisdiction, the danger exists that "some costs of plant and expenses would not be included in the rate computations of either the PUC or the FCC" and, as a result, "carrier[s] may be deprived of a fair rate of return when interstate and intrastate jurisdictions are both taken into account") (internal punctuation omitted).

id. at ¶¶ 215, 222, but tentatively concludes that it should not prescribe a mechanism for recovering the third category of costs, id. at ¶ 226-27.

U S WEST supports this proposed methodology, assuming that costs are correctly allocated among the three categories. The first category of costs — shared costs — is easy to identify. A new number portability authority will be created to implement all of the industry-wide tasks, and any costs that it incurs will fall into this first category.[19/] And the Commission correctly defines the second category — "carrier-specific costs directly related to providing number portability" (emphasis added) — in terms of cost causation.[20/] Thus, the Commission properly allocates to this category such costs as "the costs of purchasing the switch software necessary to implement a long-term number portability solution." Further NPRM ¶ 221.

But the Commission errs when it tentatively excludes all network upgrade costs from this second category. Id. at ¶ 227. Two identifiable portions of these costs are in fact "directly related to providing number portability." First, the federal number portability mandate will force local carriers to deploy network upgrades that they would not have deployed absent the mandate. Second, with respect to upgrades that the carriers would otherwise have made, the Commission's two-and-a-half-year timetable forces carriers to deploy these upgrades much

19/ As noted above, a LEC's share of these costs is no less "carrier-specific" or "directly related to number portability" than the costs assigned to the second category and should be recovered in the same fashion.

20/ This causation-based definition is consistent with the way the Commission has identified recoverable costs in the past. See, e.g., NARUC, 737 F.2d at 1115 (subscriber line charges are intended to recover "that portion of [subscribers'] necessarily incurred local telephone plant costs assigned . . . to the interstate jurisdiction" (emphasis in original)).

On the other hand, the Commission's occasional shorthand of "direct" versus "indirect" costs obscures this economically accurate, causation-based categorization. This category is more accurately defined as the "carrier-specific incremental costs of implementing number portability."

sooner than they had originally planned. Both of these costs are "directly related to" the federal number portability mandate because they are incurred solely as a result of that policy.

These unplanned-upgrade and acceleration costs are easily segregated from other network upgrade costs (namely, the costs of deploying, on their original schedule, the network upgrades that would have been made even in the absence of the number portability mandate). To calculate these costs, carriers would subtract the discounted costs associated with their original network upgrade plans from the discounted network investment costs needed to implement the long-term number portability plan on the Commission's timetable. For example, if a carrier had plans prior to the federal number portability mandate for investing in a stream of upgrades with a present-value cost of $250 million and if the Commission's order would require the carrier to make a stream of investments with a present-value cost of $600 million, then $350 million of the carrier's investment would be "directly related to providing number portability."

The Commission incorrectly suggests that because carriers may receive some benefits from deploying network upgrades in locations where they otherwise would not have, or by deploying them ahead of schedule, the costs of the unplanned upgrades and acceleration should not be attributed to the number portability mandate. Id. at ¶ 227. Rather, the proper way to account for these benefits is to subtract their value (net of any expenses and then discounted to present value) from the network upgrade costs incremental to the number portability mandate. U S WEST believes that these benefits are highly speculative and would be insubstantial; were they otherwise, U S WEST would already have made these upgrades even in the absence of the number portability mandate.

Segregating these incremental network upgrade costs and allowing their recovery (along with other "carrier-specific" and "directly related" costs) through a federal surcharge also makes economic sense. A carrier's incremental costs of upgrading its network's SS7 or AIN capabilities are, for the largest part, non-traffic-sensitive. The greatest share of these costs is for deployment of the fixed increase in capacity needed to handle the per-call database inquiries on its existing call volume. The Commission has properly recognized that non-traffic-sensitive costs should be recovered in distinct, flat surcharges rather than bundled into the per-minute rates for services: Loading these costs into per-minute charges would inefficiently inflate prices and distort service demand.[21/] The Telecommunications Act's emphasis on competitive, cost-based pricing makes it even more essential to avoid distorting prices by loading them with non-traffic-sensitive costs.[22/] In this context, it is appropriate for the Commission to segregate these non-traffic-sensitive costs of incremental network upgrades — especially given their magnitude — and allow their recovery through a direct federal surcharge instead of dropping them into the interstate cost pool as generic network costs, where they would reappear (in large part) in federal per-minute charges for unbundled network elements and access charges. Those charges already contain heavy subsidies for local service that distort the market for long distance.[23/]

The sheer size of the network upgrade costs "directly related" to the local number portability mandate distinguishes this situation from the 800-number portability context. In its

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21/ See, e.g., MTS and WATS Market Structure, Third Report and Order, 93 F.C.C.2d 241, 251-52 (1983) (creating distinct subscriber line charges to advance pricing efficiency).

22/ See, e.g., 47 U.S.C. §§ 252(d)(1), (2).

23/ See Interconnection Order ¶ 718.

800-access proceedings, the Commission did not think it was necessary to recover the cost of network upgrades through direct surcharges outside the separations process because the entire cost of those upgrades (not just the incremental costs "directly related" to providing 800-number portability) would be "relatively modest, involving an unseparated annual revenue requirement of less than $100 million for the seven BOCs combined."[24] The distortion of prices that would have resulted from bundling these costs into state and federal per-minute charges would likewise have been relatively modest. Here, by contrast, the incremental network upgrade costs are many times larger, and the distortion of prices from efficient levels would be that much more severe. This potential economic distortion justifies segregating the non-traffic-sensitive costs of network upgrades "directly related" to implementing local number portability as required by Congress and recovering those costs though a flat and distinct federal surcharge.

III. The Commission Should Establish a Framework within Which All Carriers — Including Incumbent LECs — May Impose Surcharges To Recover Their Number Portability Implementation Costs.

Incumbent LECs confront a particularly difficult challenge in recovering their costs of implementing federally mandated number portability policy. Not only must they bear the overwhelming bulk of the industry's costs of deploying a nationwide system for portability; they must also recover their costs from a customer base that, as a result of their investments in portability, will shrink in the face of competition.

These circumstances require the Commission to establish a framework that will enable incumbent LECs to recover their costs of implementing number portability from end

[24] Provision of 800 Access Service, Report and Order, 4 FCC Rcd 2824, 2833 (1989) (emphasis added).

users, resellers, and purchasers of unbundled switching over the shortest possible time. Incumbents also should have the opportunity, within that framework, to structure the federal charge so as to avoid or reduce any significant limitation on their abilities to compete on price in offering their services. On the other hand, competitive facilities-based entrants are already lightly regulated at the federal level; therefore, no affirmative Commission action is needed to give them the flexibility they need to recover their costs.

A. Incumbents Face a Unique Challenge in Deploying Number Portability and in Recovering Their Implementation Costs.

All carriers have a strong interest in number portability and in recovering their portability implementation costs. However, incumbent LECs face a unique challenge *vis-à-vis* all other carriers because (1) incumbent LECs will shoulder the great majority of the enormous costs of implementing local number portability, (2) incumbent LECs will realize little or no immediate benefit from this massive investment, and (3) the ability of incumbent LECs to recover their costs of implementing number portability will be increasingly limited as they confront more competition from existing and new competitors in the local services marketplace, while remaining subject to regulatory constraints that limit their flexibility to recover costs.

Incumbents will bear the lion's share of the costs of implementing number portability, but they will receive little immediate benefit from this expenditure. As the Commission has recognized, "most customers will be forwarding numbers from the incumbents to the new entrants."[25/] In other words, the only short-term effect of the incumbent LECs'

[25/] Order ¶ 122.

massive investments in number portability will be to make it easier for incumbents' customers to switch to their competitors, thus shrinking the customer base from which they must recover the federally mandated investment.

Incumbent LECs traditionally have not had the same cost recovery and pricing flexibility enjoyed by most other carriers. For example, CMRS providers are free of all rate regulation (state and federal), and they therefore may immediately increase the prices for their services to begin generating the cash necessary to deploy number portability (subject, of course, to any constraints imposed by the competitive marketplace). Indeed, given the Commission's (correct) decision to delay the number portability obligation on CMRS providers, such a provider could, if it so chose and market conditions permitted, establish a number portability cash reserve before spending a single dollar in implementing number portability. By contrast, incumbent LECs cannot, on a unilateral basis, either increase the prices of their services or impose a new surcharge to recover special new costs. For incumbent LECs, cost recovery methods (both type and timing) generally are determined by regulatory commissions. During the period when they must implement the federally mandated number portability policy, the ability of incumbents to recover their implementation costs may be constrained not only by regulatory oversight but also, certainly, by the rigors of an increasingly competitive marketplace.

For these reasons, the Commission should focus particularly on the problems that will confront incumbent LECs in recovering their costs of implementing number portability. The Commission need not intervene to regulate cost recovery by new facilities-based LECs because these carriers already have the flexibility they need to structure recovery of their costs.

B. The Federal Mechanism Should Permit the Promptest Possible Recovery of Directly Related Costs.

Implementing a new regulatory mandate such as number portability requires cash: cash to purchase equipment and software, and cash for the labor necessary to install and test the equipment and software and to modify existing systems. U S WEST's incumbent LEC estimates that it will require more than $400 million over the next 28 months to comply with the Commission's mandate that it be capable of supporting number portability within its top 10 MSAs by the end of 1998.[26] The costs that other incumbents will incur by that date are no doubt substantial as well. All told, the directly related costs of implementing just the first phase of federally required number portability will run to billions of dollars nationwide.

At the same time, incumbents face an increasingly uncertain environment in which to meet these cash flow needs. The introduction of competition in local service — a development that U S WEST endorses and supports — will, realistically, reduce the number of customers from which the incumbents will potentially be able to recover their costs. Ironically, the very number portability system that the incumbents must spend billions to build will be the cornerstone of the regime that makes recovery of these billions uncertain. The incumbents are not spending this money on assets that will generate revenue; rather, they must spend it on assets that will ultimately cost them revenues.[27]

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[26] Of course, additional sums will be required to implement number portability in areas outside the top 10 MSAs. The cost to deploy number portability in those areas outside the top 10 MSAs will, on a per line basis, often be larger than within these MSAs.

[27] Resort to debt or equity markets offers no ready solution. Incumbents may be able to raise in those markets the large sums necessary to assist in funding number portability deployment and the incumbents' ongoing obligations to serve as carriers of last resort and maintain service quality. But the cost of debt and equity is influenced by, among other things, the cash flow position of the company going to market. As a result, the cost of capital to incumbents may

In short, there are serious questions about the long-term opportunities for incumbents to recover their number portability costs. The Commission should therefore adopt a framework allowing for incumbents' recovery of those costs in the shortest possible time period so that the number portability regime is, to the greatest extent possible, cash-flow neutral. Accelerated recovery ensures competitive neutrality by allowing incumbents to recover substantial portions of their costs of building the competitive regime before competition fully arrives, thus putting the incumbents and entrants on a more nearly level playing field once the entrants arrive. The Commission should authorize incumbent LECs to levy a number portability surcharge that allows them to recover their deployment costs over periods that are coterminous with the periods during which they incur those costs. Similarly, incumbent LECs should be able to record expenses in the year when such directly related expenses are incurred, and should be allowed to depreciate all capital investments over a three-year life.

C. "Competitive Neutrality" Entails Allowing LECs To Recover the Costs of Number Portability from Resellers and Purchasers of Unbundled Network Elements Who Rely on the LECs To Provide Portability.

All carriers face two types of costs in providing number portability: (1) charges that will be imposed by the administrator of the regional SMS (to recover the costs associated with building and operating the SMS); and (2) capital investments and expenses that a carrier will incur in deploying number portability within its own network (or in leasing certain

substantially increase; those costs would be directly related to the federal obligation to implement number portability.

capabilities from others). The Commission asks whether incumbent LECs should recover these costs "from their end users or from other carriers."[28/]

The Commission recognizes that the costs of number portability are to be "borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission."[29/] Thus, "[w]ith respect to number portability, Congress has directed that we depart from cost causation principles if necessary in order to adopt a 'competitively neutral' standard."[30/]

Application of the "competitively neutral" standard requires each provider of telephone exchange service — incumbent or facilities-based entrant — to recover its number portability costs from its own end-user customers and not from other facilities-based carriers. It also dictates that incumbents be permitted to recover their number portability costs from resellers of their services. Indeed, such an approach is compelled by the Commission's determination in the Interconnection Order that incumbent LECs may recover subscriber line and PIC change charges from resellers (who may in turn recover those charges from end users).[31/] To rule otherwise would give resellers a windfall: their customers would enjoy the benefits of number

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28/ Order at ¶¶ 215, 222, 229.

29/ 47 U.S.C. § 251(e)(2).

30/ Order ¶131.

31/ Interconnection Order ¶¶ 981-83. The Commission's conclusion that subscriber line and PIC change charges are not subject to the wholesale pricing standard of Section 252(d)(3) of the Telecommunications Act also should apply with respect to a number portability surcharge.

portability without paying any of the costs incurred in providing this benefit. Such a result would not be "competitively neutral."[32]

The same analysis applies to carriers that purchase local switching from an incumbent pursuant to the new interconnection and unbundling rules. If a carrier is able to avoid having to deploy number portability in its own network because it uses the incumbent's network, that carrier (and ultimately its retail customers) should pay its fair share of the incumbent's number portability implementation costs. On the other hand, it would be inappropriate for an incumbent to recover a portion of its portability implementation costs from carriers purchasing only unbundled loops from the incumbent: Such carriers must still acquire their own number portability capabilities.

D. The Commission Should Establish a Framework for Incumbent LEC Recovery of the Directly Related Costs of Federally Mandated Number Portability.

The Commission should define a framework within which incumbent LECs may recover their costs directly related to implementing the number portability system that the Commission proposes to require pursuant to the Telecommunications Act. That framework should set forth the general parameters for individual incumbents' approaches to cost recovery, as set forth below. However, the Commission should leave incumbents some discretion on the details of their cost recovery plans so that such recovery can be accomplished without disabling incumbents as participants in a competitive marketplace.

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[32] To be sure, if resellers are allocated a portion of the industry-wide shared costs of implementing number portability, incumbent LECs should not be allowed to recover their own shares of those same costs from resellers.

Under the principles proposed below there is no substantial risk that incumbent LECs will impose an excessive surcharge on particular segments of the market. Actual and potential facilities-based competition will provide ample protection against such a possibility. An excessive surcharge would create a strong incentive for other carriers to build competing networks, possibly even in areas where competing networks would not have otherwise been built. Once competing facilities-based networks are constructed, the public will have the opportunity to realize the full benefits of competitive markets.

U S WEST proposes that the Commission adopt a cost recovery framework that would include, in addition to those elements discussed above, the following safeguards:

(1) Number Portability Surcharge Accounting. It would be appropriate to require incumbent LECs to identify to the Commission with specificity their directly related net costs of implementing number portability (after discounting for the benefits received from unplanned or accelerated deployment of network upgrades); to demonstrate that those costs are recovered exclusively from the federal number portability surcharge; and to show that the costs are not otherwise included in an incumbent's state or interstate rate bases.

(2) Timing of Recovery. U S WEST's incumbent LEC will incur most of its costs of complying with the federal number portability mandate within the first three years following the Commission's order. By the end of 1998, U S WEST will have fully implemented number portability in its top ten MSAs and will have built the common foundation — databases, new billing systems, and the like — for providing number portability everywhere in its service

region. By the end of 1999, competitors will likely have decided where outside the top ten MSAs they plan to compete and will have submitted their requests for number portability.

Under the principle of prompt, concurrent recovery discussed above, the Commission should allow incumbent LECs to recover these costs of implementing federal number portability through a federal surcharge over the same three-year period in which they will incur the costs. Thus, the Commission also should authorize incumbent LECs to amortize the capital costs of implementing number portability over the 36-month period beginning January 1, 1997. The surcharge will likely decrease after 1999 because the rate of requests from new entrants, and the corresponding investment requirement, should decline substantially after that date.

(3) Monitoring Reports. To verify that incumbent LECs do not recover costs unrelated to number portability through the federal surcharge, incumbents could file quarterly status reports detailing both their number portability expenditures and their federal surcharge revenues. Interested parties would have an opportunity to submit comments on the reports.

(4) Contributing Customer Base. Incumbent LECs should be permitted to recover implementation costs immediately from purchasers of unbundled local switching and from all end user customers, including resellers, wherever they are located. Spreading the costs of number portability through a region-wide, uniform surcharge will ensure a speedy recovery without overburdening any single group.